

# Intellectual Property Rights Pre-Assessment Survey

## Internal Control Testing Technical Guide

Note: This technical guide should be used where the importer may be subject to Intellectual Property Right (IPR) issues. Identifying potential IPR issues will require additional analysis such as profile information, port information, past enforcement action, or other means that indicate a past history of receipts subject to IPR. Unlike other parts of the PAS the scope and sampling should be performed on entries of current shipments where there is physical inventory to be viewed for verification of IPR

### Objective

Provide guidance for performing a PAS of the company's internal control for IPR and evaluating the results.

### Background

Generally Accepted Government Auditing Standards require the PAS team to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing, and extent of tests to be performed.

The guidelines and terms in this technical guide are based on *Assessing Internal Controls in Performance Audits*, GAO/OP- 4.1.4 - published by the United States General Accounting Office, Office of Policy, September 1990, and the American Institute of Certified Public Accountants *Statement on Auditing Standards No. 78*.

Intellectual property is the tangible product of a person's intellect or creativity. Literary works, musical scores, computer programs, paintings and drawings are a few examples of intellectual property. Depending on the nature of the intellectual property, the owner of that property may protect it from being exploited by others by registering it with the U.S. Copyright Office or the U.S. Patent and Trademark office. Customs has the responsibility for halting the importation of merchandise which violated trade names, registered trademarks, and copyrights when their owners have sought protections by recording their rights with Customs. Customs also enforces exclusion orders issued by the International Trade Commission (ITC).

In most cases importation of genuine articles without consent of the IPR owner is permissible. It is only in the case of certain trademarked items that the mark owner's consent is required for imports. Any IPR work by RAD must be coordinated closely with the Office of Field Operations and the Office of Regulations and Rulings.

Listed below are summaries of each of the IPR protected by Customs.

### Trademarks and Trade Names

The U.S. Customs Service has the authority to exclude the importation of articles in violations of a trademark and trade names. The protection requires the trademark holder to register the trademark with the U.S. Patent & Trademark Office *and* request Customs to collect and retain information related to the trademark holder's rights for a specific time. Customs monitors imports to prevent the importation of violating articles based on the trademark-holder's request or on Customs initiative.

19 CFR §§ 133.1 – 133.7 establishes the authority for registered trademarks to be recorded with Customs.

19 CFR § 133.11 – 133.15 establishes the authority for the trade names to be recorded with Customs.

19 CFR § 133.21 establishes the authority for Customs to seize imported articles bearing counterfeit trademarks.

19 CFR § 133.22 establishes the authority of the port director to detain articles bearing copying or simulating trademarks.

19 CFR § 133.23 restricts the importation of “gray market articles”. Gray market articles are foreign-made articles bearing a genuine trademark or trade name identical with or substantially indistinguishable from one owned and recorded by a citizen of the United States. Or a corporation or association created or organized within the United States and imported without the authorization of the United States owner.

19 CFR § 133.24 establishes the restrictions on articles accompanying importer and mail imports. However, 19 CFR § 148.55 provides that a person arriving in the United States may import one article of a type bearing an unauthorized protected trademark.

19 CFR § 133.25 establishes the procedures for the detention of articles that possibly violate trademark owner rights.

19 CFR § 133.26 establishes the authority for the port director to demand the redelivery of the articles that violated a copyright owner’s interest. If the articles are not redelivered to Customs, a claim of liquidated damages is made in accordance with § 141.113(h) of this chapter.

19 CFR § 133.27 establishes that Customs can file civil fines for those involved in the importation of counterfeit trademark goods.

## **Copyright**

In general, a copyright protects original works of authorship, including written music, computer programs, video games, toy designs and the intellectual creations against unauthorized reproductions, derivations, distribution or display. This protection is available to both published and unpublished works. In order to provide protections against violations of valid copyrights by foreign entities, Customs has offered copyright owners an enforcement option. Claims to copyright which have been registered in accordance with the Copyright Act of July 30, 1947, as amended, or the Copyright Act of 1976, as amended, may be recorded with Customs for import protection.

19 CFR §§ 133.31 – 133.37 establishes the authority for the copyright recordation with Customs.

19 CFR § 133.42 establishes the authority for Customs to seize imported articles that are infringing copies or records of works copyrighted in the United States.

19 CFR § 133.43 establishes the procedures for imported articles that possibly violate the copyright owner rights.

19 CFR § 133.44 establishes the authority of the port director to seize the imported article and institute forfeiture proceedings in accordance with part 162 of this chapter.

19 CFR § 133.46 establishes the authority for the port director to demand the redelivery of the articles that violated a copyright owner’s interest. If the articles are not redelivered to Customs, a claim of liquidated damages is made in accordance with § 141.113(h) of this chapter.

## **Exclusion Orders**

Under Section 337 of the Tariff Act of 1930, as amended, unfair methods of competition and unfair practices in the importation or sale of articles, the effect or tendency of which is to destroy, substantially injure, or prevent the establishment of an efficiently and economically operated in U.S. industry, or to restrain or monopolize trade and commerce in the United States, are unlawful.

19 CFR § 12.39 authorizes the procedures to restrict imported articles involving unfair methods or competition or practices. The regulation establishes procedures for the enforcement of exclusion orders and seizure and forfeiture orders of the U. S. International Trade Commission (ITC) pursuant to 19 U.S.C. 1337, which prohibits unfair methods of competition in the import trade. The ITC completes an investigation of an alleged violation to determine if the section has been violated. The Exclusion Orders are sent to the President for his final judgment to enforce the Exclusion Order. The approved Exclusion Orders are issued and administrated by the Office of Rules and Regulations, IPR Branch, but are processed by the Office of Field Operations. Once goods have been denied entry pursuant to an exclusion order, the ITC can issue a seizure and forfeiture order directing Customs to seize and forfeit future importations of the same goods by the same importer.

## **Patents**

A patent is a legal monopoly, granted by the U.S. Government, which secures to an inventor for a term of years the exclusive right to make, use, or sell his invention. U.S. Custom's patent enforcement is more limited than the trademark and copyright importation restrictions.

Customs role in enforcing patent infringement has been limited to the enforcement of certain court orders and conducting Patent Import Surveys under 19 CFR §12.39a. Patent Import Surveys are requested through the Office of Regulations & Rules, Intellectual Property Rights (IPR) Branch. When the owner of a patent registered in the United States believes that merchandise is being imported into the United States, which infringes the patent, an application for a survey to assist the patent owner in taking appropriate action may be filed. In order to assist the patent owner, Customs will, for a fee, undertake to monitor importations on a nationwide basis and report to the patent holder, the names and addresses of importers who have imported goods, which appear to infringe upon a particular patent. Regulatory Audit does not become involved in Patent Import Surveys but this information is provided for information and background purposes.

## **Mask Work**

19 CFR §12.39(e) mandates that in compliance with the Semiconductor Chip Protection Act of 1984 if a mask work registered in the copyright office seeks to have Customs deny entry to any imported semiconductor chip products which infringe on his rights, the owner must obtain a court order enjoining, or an order of the U.S. International Trade Commission (USITC) to cease the importation of such products.

The exclusion orders approved by the ITC and the President are published in the Federal Register and is available at the web address [http://www.access.gpo.gov/su\\_docs/fedreg/frcont01.html](http://www.access.gpo.gov/su_docs/fedreg/frcont01.html). This site groups the Federal Register by agency and shows the International Trade Commission publication of all importation restrictions orders for each day.

## **Examples of Red Flags**

The following examples are conditions that may indicate a potential problem with IPR.

- The company has insufficiently documented, poorly defined, or no internal control for prevention of importation of IPR protected merchandise. Examples:
  - ✓ The company does not monitor or interact with the broker on IPR issues.
  - ✓ The company relies on one employee to handle transactions where IPR issues could occur, and there are poor or no management checks or balances over this employee.
- The company does not exercise adequate control over their agents (buying/selling) regarding IPR.
- The company's import staff lacks knowledge of IPR issues.
- Company offers unreasonable explanations to Customs.
- Company fails to cooperate with or respond to Customs.
- Company has high turnover of people in key positions.
- Customs (e.g., import specialist, account manager, compliance measurements, prior audit, other Customs information) shows a history of problems with IPR merchandise.

### **Red Flags for all IPR**

- Company imports merchandise that has a readily recognizable trade name, i.e. Disney, Coca Cola, Tommy Hilfiger, Nike, but the importer does not have a royalty agreement or a license agreement with the trademark's owner.
- The company's records, i.e. purchase orders, invoices, have an IPR identifier in the merchandise description but the company does not maintain a license agreement or a royalty agreement with the IPR's owner or pays no royalties.
- Company is not aware of dutiability of royalty fees
- Profile indicates specific exporters known to have produced counterfeit merchandise in the past are vendors for the importer.
- Importer has a history of enforcement actions for IPR violations.
- Merchandise shipped in small quantities on informal entries.
- Shipment originates from a source country with known IPR problems.
- Unusually vague invoices or invoices lacking model or catalogue numbers.
- Merchandise missing lot numbers, factory codes, expiration dates, dates of manufacture, or other national requirements.
- Merchandise is shipped c.o.d. rather than by letter of credit. (the risk of seizure of the good is borne by the exporter not the importer).
- Shipment is described in vague or unusual terms, such as articles of plastic, metal discs, samples, parts, molds, dies, etc.
- Shipment is declared at an unusually low or high value for the merchandise.
- Merchandise under-insured for goods of that type.
- Merchandise imported from a country not identified by the rights holder as a country where genuine goods are manufactured.

### **Red Flags for Importers that may Manufacturer Goods of IPR Restricted Merchandise**

- Merchandise shipped in small quantities on informal entries.
- Designer or brand merchandise shipped in bulk or component parts rather than in consumer packaging, such as designer perfumes or watches that are not generally shipped in bulk or in parts.
- Shipments of merchandise described as labels, patches, tags, imprinted boxes, or dies.

- Merchandise imported from a country not identified by the rights holder as a country where genuine goods are manufactured.
- Merchandise missing copyright or trademark notice, especially on well-known copyright works or well-known trademarks.

### **Red Flags for Importers that are Distributors/Wholesalers/Mass Marketers of IPR Merchandise**

- Merchandise is of a commodity commonly counterfeited or pirated such as CDs and other media, sunglasses, watches, wearing apparel, handbags, toys, etc.
- Invoices with descriptions related to current “fad” items such as “alien doll”, “Mermaid”, or popular designers such as “Duck Logo”.
- Unusual product combinations such as collections of computer programs, video games, sound recordings when each component is a product of a different manufacturer, studio, or artist.
- Compact discs shipped on spindles and compact discs or cassettes not marked with the artist’s name or title of work.
- Compact discs, audiocassettes, or videocassettes, shipped as “blank” or “unfinished”.
- Merchandise fails to conform to country of origin marking requirements, weight designations, ingredient listings, electrical standards, consumer safety standards or other national requirements.
- Merchandise missing copyright or trademark notice, especially on well-known copyright works or well-known trademarks.
- Merchandise shipped in nonstandard packaging (watches in plastic bags rather than boxes, shoes in bags rather than boxes).
- Textile articles not labeled with fiber content or cleaning instructions.
- Clothing or other merchandise of non-standard sizing or sized to the standards of a different country.
- Merchandise is of a commodity commonly counterfeited or pirated such as computer parts.
- International mail shipments (especially of high technology goods).

### **Examples of Best Practices**

- Internal controls over IPR:
  - ✓ Are in writing,
  - ✓ Include procedures for monitoring and feedback, and
  - ✓ Are monitored by management.
- One manager is ultimately responsible for control of the Import Department, including ensuring the adherence to IPR laws and guidelines. That manager has knowledge of Customs matters and the authority to assure internal control procedures for imports are established and followed by all company departments.
- Written internal control procedures assign duties and tasks to a position rather than a specific person.
- Company has good interdepartmental communication about Customs matters, including IPR issues.
- Company and import department has access to IPR laws, guidelines, and procedures governing imported merchandise subject to IPR analysis.

- Company conducts and documents periodic reviews of its imported merchandise, having IPR implications, and uses the results to make corrections to entries and changes to their import operations as appropriate.
- Company receives authorization of the merchandise subject to IPR by appropriate agreements with the owner of the trademark, trade name, copyright or patent prior to the importation.
- Royalties, proceeds, and indirect payments related to the use of the IPR are accounted for, and where applicable included in the price actually paid or payable.
- Import department has access to, and can readily produce:
  - ✓ Documentation indicating that the IPR has been properly recorded with Customs,
  - ✓ Detailed description of imported merchandise identifying type of IPR and its specific requirements and issues,
  - ✓ Listing of all imported merchandise having IPR implications,
  - ✓ Contract(s) and/or other formal documentation indicating agreed to IPR importation practices and activities between the company and its foreign supplier(s).

### Examples of Documents and Information to Review

- Internal control policies and procedures.
- The company's response to the questionnaire.
- Interviews with company staff concerning actual procedures and controls specific to IPR issues.
- Company's documentation that supports monitoring and verification of established and/or written internal control over IPR issues.
- Documentation that identifies IPR to merchandise such as royalty agreements or license agreements with the trademark's owner and financial statements, general ledger, foreign tax reports, and schedules.
- Invoices (should show such items as model numbers, catalog numbers, lots, factory codes, and/or expiration dates).
- Letters of credit.
- Other documents affecting IPR merchandise such as purchase orders, contracts, or other formal documentation indicating agreed to IPR importation practices and activities between the company and its foreign supplier(s).

### Suggested Testing

PAS team judgement should be used to determine the type and amount of testing needed to evaluate how effective internal control is and to determine whether there is a sufficient risk to warrant proceeding to Assessment Compliance Testing (ACT).

Using the chart and guidelines below, determine through limited judgmental testing whether the company's internal control is effective.

To determine the extensiveness of internal control testing, it is necessary to evaluate:

1. The **risk exposure**, and
2. The **internal control** system by determining if the controls are in operation, how the controls were applied, how consistently they were applied, and who applied them.

## **Risk Exposure**

Risk exposure is the probability of significant Customs noncompliance. In each step in determining risk exposure, consideration should be given to:

1. Significance [to Customs] and sensitivity (i.e. issues of interest to Congress or the media, or impacting admissibility).
2. Susceptibility (of making incorrect declarations).
3. The existence of any “red flags”.
4. Management support (of strong internal control).
5. Competent personnel (to adequately administer the controls).

### *Steps to Determine Risk Exposure:*

1. Evaluate problems identified in the profile, compliance measurement rates, questionnaire, and concerns raised by the import specialist and account manager.
2. Perform the macro risk analysis tests.
3. Analyze all results to determine the risk exposure level.
4. Evaluation of risk exposure is not simply a one-time process that occurs at the start of the PAS process. Continually reassess risk exposure as more information is gathered from evaluating internal control and performing other work in the PAS.

## **Macro Risk Analysis Examples**

### *Example A: Low Risk Exposure*

A company returns the questionnaire claiming that it did not have a license agreement and no royalties were paid and the importer is not in an industry that has strong IPR protections. A review of the importation shows that the description of the product does not require a specific label be affixed to the product.

### *Example B: High Risk Exposure*

A company returns the questionnaire claiming it did not have a license agreement and paid no royalties but the importer is in an industry that has strong IPR protections, such as shoes and textiles. A review of the importation shows that the description of the product requires a specific label be affixed to the product. A subsequent query (IPRL, F5) shows that this label is registered and the manufacturer or importer is not authorized to import this merchandise.

## **System of Internal Control**

To evaluate the internal control system:

1. Consider the five components of internal control:
  - Control Environment.
  - Risk Assessment.
  - Control Activities.
  - Information and Communication.
  - Monitoring
2. Review relevant Customs and company documents to identify and understand relevant internal control over IPR. (Examples of documents and information to review are listed on prior page).
3. Determine if the company established and follows procedures. Review:
  - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
  - Documentary evidence of communication with the broker and company on IPR issues. Including verification that the broker followed company instructions.
  - Documentary evidence of inter-company communications to ensure correct information is provided to Customs.
  - Training records and materials used to educate and inform staff on IPR.
4. Review written policies and procedures and interview applicable company personnel to complete appropriate sections of the "Worksheet for Evaluating IPR Internal Control."

Note: The internal control assessment should include steps to:

- Identify and understand internal control.
- Determine what is already known about control effectiveness.
- Assess the adequacy of internal control design.
- Determine whether controls are implemented and effective.
- Determine whether transaction processes are documented.

### Extensiveness of Audit Tests (Testing Limit)

The purpose of limited PAS testing is to take a survey in order to determine the necessity for and extent of substantive tests. In some circumstances, the PAS team may decide that it probably will not be able to form an opinion based on limited PAS testing. In that case, it may be necessary to proceed immediately to the ACT process. If the PAS team believes that it can form an opinion based on limited PAS testing, test the appropriate number of controls and associated transactions using the table below.

#### Determine Extensiveness of Audit Tests

<b>Risk Exposure</b>	<b>+</b>	<b>Preliminary Review Internal Control</b>	<b>=</b>	<b>Extensiveness of Audit Test</b>	<b>Testing Limit</b>
<b>High</b>		Weak Adequate Strong		High Moderate to High Low to Moderate	10-20



<b>Risk Exposure</b>	<b>+</b>	<b>Preliminary Review Internal Control</b>	<b>=</b>	<b>Extensiveness of Audit Test</b>	<b>Testing Limit</b>
<b>Moderate</b>		Weak Adequate Strong		Moderate to High Moderate Low	5-15
<b>Low</b>		Weak Adequate Strong		Low to Moderate Low Very Low	1-10

Source: Adapted from *Assessing Internal Controls in Performance Audits*.  
Column titled "Testing Limit" reflects Customs test sizes.

#### *Example: Determine Testing Level*

Based on a review of the profile (company is in an industry heavily known for IPR), questionnaire, written procedures, etc. the team concluded that the **preliminary risk exposure was considered moderate**.

The company's internal control procedures manual required the Import Manager to review a certain number of importations associated with IPR to ensure that royalties are properly declared to Customs. In addition, an IPR review log is maintained to document this review of importations. The Import Manager documented the transactions reviewed and corrected entries as necessary. The team concluded that the **internal control system over IPR was strong**.

Using the table above (based on moderate risk exposure and strong preliminary internal control evaluation), the team concluded that they would test five control items. The team judgmentally selected importations from the IPR Review Log. The team determined that the importations were not subject to IPR and were correctly reported to Customs.

### **Evaluation of Pre-Assessment Survey Testing Results**

The following steps are guidance for determining the effectiveness of company's internal control over IPR.

1. Complete the "Worksheet for Evaluating Internal Control Over IPR" to determine whether risk determination is acceptable or unacceptable and to document why. Put the results of IPR testing in perspective and evaluate confirmed weakness as a whole. The evaluation should consider the results of the internal control testing, problems identified in the profile, and/or concerns raised by the import specialist or account manager. The team must evaluate the PAS results based on the specific situations.

Customs considers risk unacceptable when testing reveals that internal control is not effective, or not sufficient, in providing reasonable assurance that accurate, timely, and complete declarations are reported to Customs.

2. The following will assist the PAS team to determine whether conditions warrant proceeding to ACT.

- **Do not proceed to ACT (Revenue) if:**
  - ✓ Cost-benefit analysis warrants no further effort (do not spend a significant amount of resources to identify a potential loss of revenue considered insignificant).
  - ✓ The PAS indicated that the IPR error was due to an isolated incident.
  - ✓ The company agrees with PAS finding(s) and agrees to quantify the loss of revenue within an acceptable timeframe.
- **Do not proceed to ACT (Compliance) if:**
  - ✓ The error was isolated.
  - ✓ The errors were systemic and the importer agreed to develop and implement a compliance improvement plan within an acceptable timeframe.
- **Proceed to ACT (Revenue) if:**
  - ✓ Company does not have adequate internal control, and PAS indicates a material loss of revenue that cannot be quantified without statistical sampling or further review.
  - ✓ Importer will not quantify loss of revenue.
- **Proceed to ACT (Compliance) if:**
  - ✓ The company refuses to take corrective action on systemic errors and it is necessary to calculate compliance rate.

Note: If substantive tests necessary to determine a compliance rate or revenue loss can be quickly performed without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

3. Determine whether referrals should be made for enforcement action.

## Examples

The following examples of situations that might be encountered under the PAS *are for clarification purposes only*:

Note: We have only included compliance examples in this section of this technical guide due to the nature of the IPR issue. Revenue could become an issue; however our focus is to determine any potential IPR violation and proceed with the ACT or proceed to further action deemed necessary by our management.

### *Example A: Situation in which team would not proceed to ACT (Compliance)*

Ciscoctomnik Inc., (CI) imports a number of articles manufactured under IPR constraints. The exporter has indicated that the IPR merchandise is produced within the rights of the trademark holder. The internal control procedures listed in CI procedures manual requires that two conditions be met before purchasing. The two conditions are: 1) the buyer must secure from the vendor at the time the purchase order is written, a general written statement regarding the conformity of the merchandise to the trademark stipulations; and 2) the purchasing department will obtain from the vendor as part of the purchase order, a statement that the vendor will provide Customs with details of that adherence to the stipulations of the trademark. The purchase order statement also indicates any failure to supply Customs with the needed information will make the vendor liable.

The PAS process started with the import team requesting trademark information for eight items. The eight items represented all IPR products that CI imports. Due to the conditions set in the purchase orders the documents were promptly available. The PAS Team reviewed CI's documentation that confirmed the vendor's adherence to the trademark stipulations and CI's application of internal control procedures. Therefore, proceeding to ACT was not considered necessary.

*Example B: Situation in which the team would proceed to ACT (Compliance)*

CI has the same controls as in Example A above except that on two of the eight items they could not produce the trademark information. During the limited PAS testing, it was also discovered that written internal control procedures were not always being followed. The PAS team agreed that they would proceed to ACT to perform additional analysis.

## Worksheet for Evaluating Internal Control Over IPR

Objective: Determine whether the company has procedures designed to effectively control Customs risks related to IPR.

**Risk Determination:**

**Acceptable** \_\_\_\_\_

**Unacceptable** \_\_\_\_\_

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Are internal controls over the manufacture or import of IPR products formally documented?						
Are written policies and procedures approved by management?						
Are written policies and procedures reviewed and updated periodically?						
Is one manager responsible for control of the Import Department, including IPR products ?						
Does that manager have knowledge of Customs matters and the authority to ensure that internal control procedures for imports of IPR products are established and followed by all company departments?						
Do written internal control procedures assign IPR duties and tasks to a position rather than a person?						

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Does company have good interdepartmental communication about IPR matters?						
Does company conduct and document periodic reviews of products of IPR?						
Does company use the IPR periodic review results to make corrections to past and present entries?						
Does the company use periodic review results to make corrections to its import operations?						
Do internal controls involve a verification process to determine that the imported IPR merchandise is correctly labeled or properly marked?						
Is adequate descriptive information provided to the Import Department and/or broker to ensure proper declaration of IPR imports?						
Does the importer have procedures to obtain any required or necessary copyright or trademark documentation?						
Does the importer maintain an IPR database or listing of imported merchandise that would readily identify IPR merchandise?						

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Does the company perform an annual review of changes to IPR?						
Does the individual overseeing compliance with products of IPR requirements have adequate knowledge and training?						
<b>New IPR Merchandise</b>						
Does management review the classification and eligibility of new IPR items?						
Is responsibility for the IPR eligibility process assigned to one knowledgeable individual or department with management oversight?						
<b>Internal Control Conclusions</b>						
Does the company provide adequate broker oversight?						
Did PAS testing verify that control procedures were being followed?						
Do interviews with responsible persons support control procedures?						
Does the company have internal control to address specific issues identified in the profile?						

<b>Internal Control</b>	<b>Yes</b>	<b>No</b>	<b>Not Applicable</b>	<b>Internal Control Manual Page Number</b>	<b>Work Paper Reference</b>	<b>Comments</b>
<b>List company-specific procedures and controls below (if applicable)</b>						